

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission	:	
On Its Own Motion	:	
-vs-	:	
Peoples Gas Light and Coke Company	:	06-0752
Reconciliation of revenues collected	:	
under gas adjustment charges with actual	:	
costs prudently incurred.	:	
Illinois Commerce Commission	:	
On Its Own Motion	:	
-vs-	:	
Peoples Gas Light and Coke Company	:	07-0312
Reconciliation of revenues collected	:	(Cons.)
under gas adjustment charges with actual	:	
costs prudently incurred.	:	

PROPOSED ORDER

By the Commission:

I. Procedural History

On November 21, 2006, the Illinois Commerce Commission (“Commission”) entered an Order Commencing PGA Reconciliation Proceedings directing The Peoples Gas Light and Coke Company (“Peoples Gas,” the “Company” or “Respondent”) to present evidence at a public hearing in this docket showing the reconciliation of revenues collected under its Purchased Gas Adjustment (“PGA” or “Gas Charge”) tariff with the actual cost of gas supplies prudently incurred and recoverable under the Gas Charge tariff for the twelve-month period ended September 30, 2006 (Docket 06-0752).

Peoples Gas posted, in its business offices, notice of the filing of its testimony and exhibits with the Commission. Peoples Gas caused notice to be published in a newspaper having general circulation in its service territory in the manner prescribed by 83 Ill. Adm. Code 255, in compliance with the November 21, 2006 Order.

On August 3, 2006, WPS Resources Corporation, Peoples Energy Corporation, Peoples Gas and North Shore Gas Company (“North Shore”) filed an application pursuant to Section 7-204 of the Public Utilities Act (“Act”) for authority to engage in reorganization. The Commission approved the application on February 7, 2007, in Docket 06-0540. Included in the application, Peoples Gas and North Shore proposed to change their reconciliation years

from the 12-month period ending September 30 to the 12-month period ending December 31 and to facilitate the transition through a three-month reconciliation period covering October 2006 through December 2006. The Commission granted these requests in the Order approving the reorganization.

To address the three-month interval spanning October 1, 2006, through December 31, 2006, the Commission, on May 16, 2007, entered an Order Commencing PGA Reconciliation Proceedings directing Peoples Gas to present evidence at a public hearing in this docket showing the reconciliation of revenues collected under its Gas Charge tariff with the actual cost of gas supplies prudently incurred and recoverable under the Gas Charge tariff for the three-month period ended December 31, 2006 (Docket 07-0312) (together with the twelve-month period ended September 30, 2006, the "Reconciliation Period").

Peoples Gas posted, in its business offices, notice of the filing of its testimony and exhibits with the Commission. Peoples Gas caused notice to be published in a newspaper having general circulation in its service territory in the manner prescribed by 83 Ill. Adm. Code 255, in compliance with the May 16, 2007 Order.

On July 25, 2007, the Administrative Law Judge granted Staff's motion to consolidate Dockets 06-0752 and 07-0312.

An evidentiary hearing was held on December 11, 2008. Appearances were entered by counsel on behalf of the Company, the People of the State of Illinois ("AG"), the Citizens Utility Board ("CUB"), the City of Chicago ("City") and Staff. Peoples Gas presented the testimony of Christine Gregor, Assistant Controller, Peoples Gas; and Richard E. Dobson, Manager of Gas Supply, Peoples Gas. CUB, City and the AG jointly presented the testimony of Jerome D. Mierzwa, Principal and Vice President of Exeter Associates, Inc. Staff presented the testimony of Dianna Hathhorn, Accountant, Accounting Department of the Financial Analysis Division; Dennis L. Anderson, Senior Gas Engineer in the Gas Section of the Engineering Department of the Energy Division; and David Rearden, Senior Economist in the Policy Program of the Energy Division.

The record was marked "Heard and Taken."

On February 6, 2009, Peoples Gas, the Staff and, filing jointly, CUB, City and the AG each filed an initial brief.

On February 27, 2009, Peoples Gas, Staff of the Illinois Commerce Commission, the City of Chicago, the People of the State of Illinois, and the Citizens Utility Board each filled a reply brief.

On February 27, 2009, the Citizens Utility Board, the City of Chicago and the People of the State of Illinois and Peoples Gas each filed a draft order.

On May 19, 2010, the Administrative Law Judge issued a Proposed Order.

II. PRUDENCE

Section 9-220(a) of the Act provides, in pertinent part, that:

Annually, the Commission shall initiate public hearings to determine whether the [purchased gas adjustment] clauses reflect actual costs of fuel, gas, power, or coal transportation purchased to determine whether such purchases were prudent, and to reconcile any amounts collected with the actual costs of fuel, power, gas, or coal transportation prudently purchased.

220 ILCS 5/9-220(a).

In accordance with Section 9-220(a) of the Act, the Commission evaluates prudence under the following standard:

Prudence is that standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made. In determining whether a judgment was prudently made, only those facts available at the time judgment was exercised can be considered. Hindsight review is impermissible.

Imprudence cannot be sustained by substituting ones' judgment for that of another. The prudence standard recognizes that reasonable persons can have honest differences of opinion without one or the other necessarily being "imprudent."

Commonwealth Edison Company, Docket No. 84-0395, Order dated October 7, 1987, at 17. Also see, Illinois Power Co. v. Illinois Commerce Comm., 245 Ill. App. 3d 367, 371 (3rd Dist. 1993).

III. ISSUES

There are three uncontested issues and one contested issue in this proceeding.

A. Uncontested Issues

1. Bank Gas Liability

One uncontested issue in this proceeding concerns the banked gas reconciliation adjustment. When transportation customers deliver more gas to Peoples Gas than they consume, the excess deliveries are banked on the customers' behalf. Mr. Mierzwa, describing Peoples Gas' fiscal year 2005 reconciliation case (Docket No. 05-0749), testified that the Company failed to track accurately banked volumes. Staff witness Hathhorn proposed a gas cost disallowance of \$571,933.44 for a reconciling adjustment made by Peoples Gas in September of 2006 for banked gas for items not identified and presumed to be prior to the reconciliation period. Ms. Hathhorn testified that, since the Company cannot identify items related to the Reconciliation Period for this item, and in

accordance with the Commission's Order in Docket 05-0749, this adjustment is appropriate to disallow non-Reconciliation Period costs from the Gas Charge. Staff proposed refunds through Factor O of \$571,933.44 for the Commodity Gas Charge. Mr. Mierzwa proposed an identical adjustment. Staff did not propose adjustments to the Non-commodity Gas Charge, Demand Gas Charge, Aggregation Balancing Gas Charge, and the Transition Surcharge.

Peoples Gas witness Gregor testified that Peoples Gas would not contest the recommended disallowance of \$571,933.44 for the banked gas issue.

The Commission finds that the costs at issue were not incurred during the Reconciliation Period and should be refunded to customers through a Factor O of \$571,933.44 for the Commodity Gas Charge.

2. Issue that Peoples Gas Will Address in Its 2007 Case

Dr. Rearden recommended that Peoples Gas supplement its direct testimony in its 2007 Gas Charge reconciliation case to describe its contract with Kinder Morgan Illinois Pipeline ("KMIP") and related portfolio issues. He stated that the KMIP contract became operational in late 2007. ICC Staff Ex. 3.0, pp. 7-8. Peoples Gas agreed to submit such testimony. Peoples Gas Ex. RD 3.0, p. 4. Staff stated that Peoples Gas filed this testimony in Docket No. 07-0577 on October 31, 2008. Staff In. Br., p. 9.

The Commission finds that it is appropriate for Peoples Gas to file supplemental direct testimony concerning the KMIP contract. As Peoples Gas has already filed such testimony, it is unnecessary to address this proposal further in this proceeding.

3. Issue that Peoples Gas Will Address in Its 2008 Case

Dr. Rearden recommended that Peoples Gas describe, in its 2008 Gas Charge reconciliation direct testimony, how it intends to allocate Manlove Field capacity among Peoples Gas, North Shore and Peoples Gas' interstate services¹. Dr. Rearden stated that such testimony should explain the basis for the Manlove Field plans and how it dovetails into the portfolio of assets, such that Staff can evaluate actual usage against those standards. ICC Staff Ex. 3.0, pp. 6-7. Peoples Gas agreed to address this allocation in its 2008 direct testimony. Peoples Gas Ex. RD 3.0, p. 4. Staff proposed a specific finding and a specific ordering paragraph to address this matter. Staff In. Br., p. 6.

The Commission finds that it is appropriate for Peoples Gas to address, in its 2008 Gas Charge reconciliation direct testimony, how it intends to allocate Manlove Field capacity among Peoples Gas, North Shore and Peoples Gas' interstate services.

¹ As discussed below, Staff, intervenors and the Company refer to the interstate services as "hub" services.

B. Contested Issue

CUB-City-AG witness Mierzwa recommended a cost disallowance related to Peoples Gas' use of its Company-owned storage field, Manlove Field. Staff did not recommend any gas cost disallowances for this issue. There were no other contested issues concerning the prudence of the Company's gas costs.

1. Gas Supply Procurement

Company witness Dobson testified that Peoples Gas' Gas Supply Department, and others, as appropriate, developed specific gas supply recommendations for management approval. The Gas Supply and Engineering Division was responsible for entering into and administering supply and capacity contracts. Each month, Gas Supply Department personnel met to address purchasing decisions for the upcoming month. Mr. Dobson stated that, on a daily basis, as changing requirements and the market dictated, these personnel addressed any changes necessary to accommodate the need for additional supply or capacity or the opportunity to release additional supply or capacity. Peoples Gas Ex. RD 1.0, p. 3; Peoples Gas Ex. RD 2.0, p. 3.

According to Mr. Dobson, during the Reconciliation Period, Peoples Gas made no significant changes to its pipeline storage and capacity portfolio. Peoples Gas Ex. RD 1.0, p. 14; Peoples Gas Ex. RD 2.0, p. 6.

Mr. Dobson stated that Peoples Gas purchased firm gas supply from many parties under three general forms during the Reconciliation Period: field baseload quantities, multi-attribute term citygate quantities using capacity released to the suppliers, and citygate delivered call gas. Peoples Gas Ex. RD 1.0, p. 4; Peoples Gas Ex. RD 2.0, p. 3.

Mr. Dobson stated that Peoples Gas contracted for baseload gas supplies, on a long-term and seasonal basis, at field locations and transported the gas to the citygate using transportation Peoples Gas held. Baseload contracts called for Peoples Gas to purchase a uniform quantity each day. The multi-attribute term citygate quantities using capacity released to the suppliers consisted of two contracts with a term of two and one-half years that covered three full winter periods. Citygate delivered call gas purchases were supplies that suppliers delivered to Peoples Gas' citygate on a firm basis, subject to the unique call rights specified in the contract. According to Mr. Dobson, some call rights were available on any day during the December 2005 through February 2006 and the December 2006 through February 2007 periods at a daily index price. Other call rights were tied to a weather criterion and were available in January 2006 at a first of month price. The call right agreements required the seller to deliver gas that Peoples Gas nominated, but Peoples Gas had no obligation to trigger the call. Peoples Gas Ex. RD 1.0, pp. 4-5; Peoples Gas Ex. RD 2.0, pp. 3-4.

According to Mr. Dobson, Peoples Gas purchased part of its supply as spot purchases from over twenty suppliers under the terms of the individual master contracts. The spot transactions typically provided gas on a short-term basis. Peoples Gas Ex. RD 1.0, pp. 5-6; Peoples Gas Ex. RD 2.0, p. 4. Customer-owned gas was another source

available to Peoples Gas for system supply. Peoples Gas Ex. RD 1.0, p. 5; Peoples Gas Ex. RD 2.0, p. 4. Finally, Peoples Gas purchased supply from its affiliate, Peoples Natural Gas Liquids, LLC, under a Commission-approved peaking service contract (Docket No. 96-0452). Peoples Gas Ex. RD 1.0, p. 6.

Mr. Dobson testified that Peoples Gas used requests for proposal (“RFPs”) to acquire its firm supplies, some of which it issued prior to the Reconciliation Period. For example, Peoples Gas issued an RFP for baseload supply that it sent to twenty-seven suppliers and ten suppliers submitted bids. As a second example, Peoples Gas issued an RFP to twenty-seven suppliers for supply to fill its storage services, and it received twenty-one replies of which fifteen were conforming bids. Peoples Gas Ex. RD 1.0, pp. 11-12. Mr. Dobson stated that Peoples Gas attempted to be as clear as possible in what it was seeking and what it would consider a conforming bid. This provided objective criteria to eliminate non-conforming bids and to make a fair apples-to-apples comparison of bids received. Peoples Gas Ex. RD 1.0, pp. 6-7; Peoples Gas Ex. RD 2.0, p. 4. According to Mr. Dobson, Peoples Gas’ primary consideration in evaluating RFPs was price. The physical location of the supply, *e.g.*, the pipeline on which it would be delivered to Peoples Gas, was a secondary consideration in some cases. Peoples Gas Ex. RD 1.0, pp. 12-13; Peoples Gas Ex. RD 2.0, p. 6.

Mr. Dobson described measures Peoples Gas took to insulate the Gas Charge from price volatility, including Peoples Gas’ hedging strategies. First, he stated that Peoples Gas followed a price protection program designed to mitigate the effects of gas price volatility. Under this program, Peoples Gas protected part of its purchases at fixed prices or within fixed-price collars. It began executing its hedges approximately eight months prior to the start of each season (*i.e.*, winter or summer), and it executed its hedge transactions relatively evenly over that period. Under normal weather conditions, Peoples Gas would expect to hedge between 50% and 60% of its annual purchases. Peoples Gas Ex. RD 1.0, pp. 19-20; Peoples Gas Ex. RD 2.0, p. 7. Second, Peoples Gas’ company-owned and purchased storage provided a natural physical hedge. Peoples Gas Ex. RD 1.0, p. 19; Peoples Gas Ex. RD 2.0, p. 7. Third, Peoples Gas purchased gas from a variety of parties and from different producing regions to protect against regional price anomalies. Peoples Gas Ex. RD 1.0, p. 19; Peoples Gas Ex. RD 2.0, p. 7.

Staff witness Anderson stated that he reviewed the Company’s testimony and responses to numerous Staff data requests that directly addressed issues related to the prudence of Peoples Gas’ natural gas purchasing. He concluded that he found no reason to dispute the Company’s assertion that all gas supply purchases were prudently incurred during the Reconciliation Period. ICC Staff Ex. 2.0, p. 3; ICC Staff Ex. 3.0, pp. 2-3.

The Commission, based on its review of the record, finds that Peoples Gas’ gas supply procurement processes, particularly its use of RFPs and its price protection strategies, during the Reconciliation Period were prudent. The Commission separately addresses questions raised in connection with Peoples Gas’ use of its storage field.

2. Manlove Field

a. Background

Manlove Field is Peoples Gas' company-owned storage field. Mr. Dobson testified that Peoples Gas uses Manlove Field to serve its retail customers' requirements and to support interstate services, which it calls "hub" services. Hub services are storage and transportation services that Peoples Gas offers under the Federal Energy Regulatory Commission's authority. According to Mr. Dobson, Peoples Gas supports hub services using seasonally available capacity at Manlove Field and the Mahomet gas transmission line ("Mahomet Pipeline"). The Mahomet Pipeline connects Manlove Field with Peoples Gas' service territory. Mr. Dobson stated that Peoples Gas designs the hub services to use the seasonally available injection, withdrawal and underground storage capacity at Manlove Field that, from time to time, is in excess of retail customers' requirements and to take advantage of the flexibility provided by the multiple interstate pipeline interconnections with the Mahomet Pipeline. Peoples Gas Ex. RD 3.0, p. 5. Peoples Gas flows hub transaction revenues through the Gas Charge, *i.e.*, hub revenues reduce recoverable gas costs. Peoples Gas Ex. RD 1.0, p. 21; Peoples Gas Ex. RD 2.0, p. 8. During the Reconciliation Period, hub revenues were about \$15.2 million. Peoples Gas Ex. CG 1.1; Peoples Gas Ex. CG 2.1.

CUB-City-AG witness Mr. Mierzwa described hub services as transactions under which Peoples Gas either accepts gas from a counterparty and returns it at a later time ("park") or lends gas to a counterparty who returns it at a later time ("loan"). CUB-City-AG Ex. 1.0, p. 4. He stated that he is concerned that the provision of hub services reduces the amount of storage gas that can be used to meet ratepayers' winter requirements, and this can result in higher costs to sales customers because the quantity of lower cost summer gas available to sales customers is reduced. CUB-City-AG Ex. 1.0, p. 5. He concluded that, during the Reconciliation Period, hub services increased gas costs to sales customers. CUB-City-AG Ex. 1.0, pp. 5-6. CUB-City-AG recommended a cost disallowance of \$11,027,496. CUB-City-AG In. Br., p. 8.

b. CUB-City-AG Recommendation

Mr. Mierzwa testified that counterparties generally enter into hub transactions to capitalize on seasonal gas price differentials. He presented an example based on New York Mercantile Exchange ("NYMEX") prices in February 2005 for March 2005 and for December 2005 delivered gas. Theoretically, he stated that a party would be willing to pay \$1.40 per dth for delivery to the Company in March and returning the gas in December. However, Mr. Mierzwa testified that ratepayers received only 66.5¢ per dth in hub revenues. He characterized this example as representative of the inherent problem with hub transactions. CUB-City-AG Ex. 1.0, pp. 6-8.

Mr. Mierzwa then testified that the Company allocates a predetermined portion of Manlove Field capacity for use in meeting system supply storage needs. He stated that the allocation has not changed over many years. In Mr. Mierzwa's opinion, it is unreasonable

for the Company to predetermine and limit the quantity of Manlove Field storage capacity used to serve ratepayers. CUB-City-AG Ex. 1.0, pp. 8-9.

Mr. Mierzwa performed a calculation of what he called the “effect of hub services on gas costs.” The calculation looked at gas received and delivered over the period March 2005 through February 2007 and applied a market price to the activity. This calculation produced a total effect of about \$23.6 million. He then offset this amount by about \$9.7 million for “hub revenue credits” to produce a net impact of \$13.9 million. CUB-City-AG Ex. JDM-2. In its Initial Brief, CUB-City-AG explained that, based on a revised Company data response that it received subsequent to submitting Mr. Mierzwa’s testimony, Mr. Mierzwa modified his calculation to produce a recommended disallowance of about \$11 million. CUB-City-AG In. Br., p. 8.

In response to the Company, Mr. Mierzwa stated that certain incremental costs cited by the Company as added costs that the Company would incur if it used additional Manlove Field capacity (injection fuel and carrying costs) are recovered through base rates and singling them out is improper single issue ratemaking. However, he calculated the effect on his recommendation of taking these costs into account, and the impact was to reduce his recommendation from \$13.9 million to \$9 million. CUB-City-AG Ex. 2.0, pp. 5-6. He also explained that he was not claiming that the pattern of transactions he used in his computation was optimal. The storage activity assumed that Peoples Gas used the capacity assigned to hub services in the same manner it used to provide hub services. According to Mr. Mierzwa, had it been used consistent with planned Manlove activity, the net adverse impact would have been reduced from \$13.9 million to \$9.9 million. CUB-City-AG Ex. 2.0, pp. 6-8.

Additionally, in response to the Company, Mr. Mierzwa stated that his calculation was based on park and loan transactions only and not other sorts of hub transactions. Accordingly, the amount of revenue that he used to offset his computed costs was only the park and loan revenue. Similarly, the quantity of gas was only the amount used for this type of transaction. He also stated that his calculation included transactions beginning or ending outside the Reconciliation Period because it was necessary to determine the gas cost impact during the period. Under Mr. Mierzwa’s proposal, Peoples Gas could displace both baseload and swing supplies. This is because Peoples Gas does not operate Manlove Field as a baseload facility. CUB-City-AG Ex. 2.0, pp. 9-13. Mr. Mierzwa also testified that, if Peoples Gas displaced certain of its baseload purchases through increased use of Manlove Field, it could release capacity and generate capacity release credits that would offset gas costs. CUB-City-AG Ex. 2.0, pp. 13-14.

c. Staff Position

Staff did not propose a disallowance for Manlove Field during the Reconciliation Period. Staff witness Dr. Rearden did not believe Peoples Gas adequately analyzed how it used Manlove Field, but Staff had no basis for concluding that the use was imprudent. Dr. Rearden also explained that it is not administratively efficient to investigate Manlove Field’s effect on gas cost in this proceeding when it is being considered in other proceedings. ICC

Staff Ex. 3.0, p. 6. He explained that Peoples Gas submitted information about future allocation decisions. Dr. Rearden questioned the analytical tools used for the decisions and made certain proposals that concern future proceedings. ICC Staff Ex. 5.0, pp. 5-8.

In response to Mr. Mierzwa's testimony, Dr. Rearden stated that there are significant shortcomings in his calculation that prevent it from being used to calculate a disallowance. Dr. Rearden specifically identified two problems, namely that the period of the calculations does not coincide with the Reconciliation Period and the amount of revenues he used was lower than actual revenues. ICC Staff Ex. 5.0, p. 4.

d. Peoples Gas' Response

Peoples Gas witness Dobson testified that Peoples Gas' storage portfolio includes pipeline services and the company-owned storage field, Manlove Field. Peoples Gas' planning for the Reconciliation Period provided that Manlove Field would meet 43.6% of Peoples Gas' design day sendout and it represented 41.1% of its annual storage portfolio. Peoples Gas Ex. RD 1.0, p. 15; Peoples Gas Ex. RD 2.0, p. 7. According to Mr. Dobson, Peoples Gas met about 75% of its customers' fiscal 2006 peak day requirements from company-owned and pipeline storage. To fill all storage services, Peoples Gas buys the gas needed to fill these services to the targeted level over the entire injection season using a time driven plan. Mr. Dobson stated that this approach allows ratepayers to gain the full benefit of the summer/winter differential available at the time the purchase decision is made. This time driven plan removes speculation from the injection decision, and this lowers the risk that Peoples Gas will purchase gas for its customers in the higher costs months. Peoples Gas Ex. RD 3.0, pp. 11-12. Additionally, customers gain the certainty of the revenue credits from hub transactions without sharing in the risk that the seasonal price differential, expected at the time of the transaction, shrinks or turns negative. Peoples Gas Ex. RD 3.0, p. 12.

In response to Mr. Mierzwa's testimony that Peoples Gas predetermines the amount of Manlove Field to use for system supply, Mr. Dobson stated that Peoples Gas took Manlove Field operating parameters into consideration when developing its portfolio, just as it took other limiting factors into consideration. One key Manlove Field parameter is the need to cycle the entire amount that Peoples Gas planned to inject for customers, including under warm weather conditions. Peoples Gas used its Gas Dispatch Model to fine-tune the portfolio and test it under a variety of weather conditions. Peoples Gas Ex. RD 3.0, p. 9.

Mr. Dobson explained that, as part of its forecasting process, Peoples Gas prepared a regression analysis for each month of the Reconciliation Period, correlating the daily firm load sendout with the corresponding degree days and day type. Generally speaking, the Gas Dispatch Model calculates the daily sendout requirement by summing the per day (base load) factors for all categories and adding to this total the product of the variable per degree day factor multiplied by the number of heating degree days ("HDD") projected for a given day. Since normal HDD reflect the "average" that would be expected for any particular day, they do not reflect the day-to-day variations in HDD that usually occur. For that reason, Mr. Dobson stated that Peoples Gas developed a normal weather pattern that,

while containing monthly totals that equal the monthly normal HDD, contains fluctuations in the daily HDD. Peoples Gas Ex. RD 3.0, pp. 9-10.

According to Mr. Dobson, the Gas Dispatch Model calculates daily sendout requirements and balances the normal year's daily requirements with gas supply available. The Gas Dispatch Model optimizes, from a full year viewpoint, using a cost minimization objective function, the daily gas dispatching activity in forecasting the supply and storage mix necessary to meet the customer sendout requirements for each day of the forecast year. Mr. Dobson stated that the Gas Dispatch Model typically tests between 6,000 and 8,000 combinations of purchases, injections, and withdrawals before determining the optimal dispatch.

Mr. Dobson explained that the Gas Dispatch Model takes several restrictions into account and not merely those associated with Manlove Field. One example is the rights associated with Peoples Gas' pipeline storage services that are limited by the pipeline's tariffs. A specific example is that some services have minimum and maximum injection and withdrawal limits. Additionally, the model assumes all gas injected by hub customers is taken out, no matter the actual weather, even if hub customers would rather not withdraw the gas. Peoples Gas Ex. RD 3.0, p. 11.

Peoples Gas stated that there are several flaws in Mr. Mierzwa's calculation.

First, Mr. Dobson stated that Mr. Mierzwa's claimed costs of hub transactions are based on 24 months of operations, yet the credit he applies appears to only reflect credits from park and loan activities for the September 2005 through December 2006 period. There are three mismatches in this calculation: (1) the Reconciliation Period is only 15 months, (2) if a 24-month analysis is used, then 24 months of revenue should offset the claimed costs, and (3) park and loan transactions are only one type of hub service. Peoples Gas Ex. RD 3.0, p. 7. While Peoples Gas disagrees that the analysis is appropriate, Mr. Dobson testified that correcting only the second mismatch shows a benefit to customers from the hub because 24 months of hub revenues (\$27.5 million) exceeds Mr. Mierzwa's calculated costs by about \$3.9 million. Peoples Gas Ex. RD 3.0, p. 8. Even using only park and loan revenues would almost double the amount of revenue shown in Mr. Mierzwa's Schedule 2.² In other words, according to Peoples Gas, the mismatched time periods substantially distort the results. Peoples Gas In. Br., p. 15.

Second, Mr. Dobson stated that Mr. Mierzwa's calculation is based on a specific set of quantities falling in particular months and application of a "market price." The resulting figure assumes transactions can be done at exactly the prices he quotes and at the times that are optimum. According to Mr. Dobson, this is not an accurate representation of how Peoples Gas conducts hub transactions. In many cases, Mr. Dobson stated, Peoples Gas negotiates a hub transaction value based on non-baseload injections and planned baseload withdrawals. It may negotiate non-baseload injections on a day to day basis

² Schedule 2 shows \$9.7 million of hub revenue. CUB-City-AG Ex. 1.0, Sch. 2. For the 24-month period shown on the schedule, park and loan revenues were about \$17.2 million. Peoples Gas Ex. 3.0, p. 8.

within an injection month, aggregated to the withdrawal month, to provide Peoples Gas and the customer a known baseload withdrawal quantity for planning purposes. This gives Peoples Gas the flexibility to reject injections during the injection month if operating conditions do not allow and to limit withdrawals to those quantities that can be supported or interrupted if necessary. Peoples Gas Ex. RD 3.0, p. 7.

Third, Peoples Gas argued that Mr. Mierzwa's testimony is unclear about the additional quantity of gas that he contends should have been injected into Manlove Field to provide service to retail customers. According to Peoples Gas, it is unclear if Mr. Mierzwa believes Peoples Gas should have used an additional 10 Bcf to serve retail customers or 6 Bcf or 7 Bcf. Peoples Gas In. Br., pp. 16-17.

Fourth, Peoples Gas agrees with Mr. Mierzwa that, during the Reconciliation Period, it did not use 10 Bcf to support park and loan transactions. However, whatever the quantity, Mr. Dobson stated that a problem with Mr. Mierzwa's analysis is that it focuses only on park and loan transactions and disregards the other types of hub transactions, which are dependent on Manlove Field. Peoples Gas Ex. 3.0, p. 9; Peoples Gas Ex. 4.0, p. 4.

In response to Mr. Mierzwa's point about possible capacity release activity, Mr. Dobson stated that a redesigned portfolio may not be able to generate capacity release credits for several reasons. The value of the capacity would depend on its path (from where it comes and to where it goes). Also, Mr. Dobson stated that adding a recall provision usually reduces the value a replacement shipper places on capacity. Mr. Dobson further explained that, once recalled, gas supply needs to be obtained to fill the capacity and that may not be possible in a timely manner; the cost of that supply is likely relatively high due to the otherwise high demand being experienced in the market. Peoples Gas Ex. RD 4.0, p. 11.

Finally, Peoples Gas contends that CUB-City-AG is inconsistent in its discussion of what transactions would be displaced by increased use of Manlove Field. If one of the determinations that CUB-City-AG is asking the Commission to make is a cost disallowance based on a different use of Manlove Field, Peoples Gas argues that it is hardly irrelevant, as CUB-City-AG stated in its initial brief, whether Manlove Field is operated as a baseload facility. Mr. Dobson testified that Manlove Field is essentially a baseload operation. Peoples Gas Ex. 4.0, pp. 5-7.

e. Commission Analysis and Conclusions

As CUB-City-AG pointed out in their initial brief, the Commission had similar issues before it in Peoples Gas' 2005 Gas Charge reconciliation proceeding. In that case (Docket 05-0749), the Commission noted that hub issues were being addressed in Peoples Gas' then pending rate case (Docket No. 07-0242). Subsequently, in that rate case, the Commission addressed Peoples Gas' interstate services at length. The rate case test year was Peoples Gas' fiscal year 2006, which was the twelve months ended September 30, 2006. The Peoples Gas Light and Coke Company, ICC Docket Nos. 07-0241 and 07-0242

(Cons.), p. 7 (February 5, 2008) (“2008 Rate Order”). The Reconciliation Period in this case includes that same fiscal year plus the ensuing three months (October 1, 2006, through December 31, 2006).

The Commission’s review of Peoples Gas’ interstate services addressed several arguments about the costs and benefits of those services. 2008 Rate Order at 102-121. That review included Mr. Mierzwa’s arguments concerning the “predetermination” of the amount of Manlove Field capacity allocated to system supply. 2008 Rate Order at 110-111. The Commission stated that “[c]onsidering all of the relevant evidence at hand, the Commission is persuaded that, at this time, the Hub provides more benefits than costs. We come to this conclusion by examining all of the relevant evidence.” 2008 Rate Order at 116-117; *also see* Peoples Gas Ex. RD 3.0, p. 5.

The Commission has already reviewed the costs and benefits of the interstate services in a proceeding directly involving twelve of the fifteen months at issue in this proceeding. It specifically addressed the monetary and non-monetary benefits to customers of the interstate services. It found “the record devoid of any evidence that Peoples Gas has utilized any of the Gas Charge assets to subsidize Hub services.” 2008 Rate Order at 117. It concluded that the interstate services provide more benefits than costs. 2008 Rate Order at 117. Those conclusions are directly relevant to this Reconciliation Period. Nothing in the record in this proceeding leads us to a different conclusion from that reached in the rate case about the prudence of Peoples Gas’ use of its Manlove Field and its provision of hub services during the Reconciliation Period.

As Staff and the Company pointed out, the calculation of CUB-City-AG’s recommended disallowance does not appear to be consistent. It uses only some hub transactions (what are called “park and loan” transactions), and it is not clear why others were excluded. The calculation also spans a period greater than the Reconciliation Period, yet it uses only revenues from the Reconciliation Period for the so-called park and loan transactions.

The intervenor witness also offered at least two alternatives that substantially reduce the costs he attributed to hub transactions. In one alternative, he removed certain incremental costs and reduced his recommendation by \$4.9 million. In a second calculation, he used a different pattern for storage usage that reduced his calculation by about \$4 million. Coupled with the differing time periods used for costs and revenues, it is not evident that, even assuming Peoples Gas had used additional Manlove Field capacity for ratepayers, there would have been benefits that outweighed the hub revenues flowed through the Gas Charge in the Reconciliation Period.

The Commission exhaustively reviewed the costs and benefits of hub services in Peoples Gas’ 2008 rate case. It concluded that the benefits outweighed the costs at that time. Nothing in the record in this proceeding is contrary to those conclusions.

IV. Reconciliation Statement

Company witness Gregor addressed the fourteen specified data that the Commission's Orders required Peoples Gas to address. Ms. Gregor sponsored Peoples Gas' Determination of Reconciliation Balance for Gas Charge Year Ended September 30, 2006, and for the three-month period ended December 31, 2006, as well as the audit reports of Peoples Gas' independent public accountants for both periods. Peoples Gas Exs. CG 1.0, 1.1, 2.0, 2.1.

As discusses above, Staff witness Hathhorn recommended a Factor O, applicable to the Commodity Gas Charge reconciliation. The Company did not oppose the proposal.

V. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the entire record and being fully advised in the premises, is of the opinion and finds that:

- (1) The Peoples Gas Light and Coke Company is an Illinois corporation engaged in the distribution of natural gas to the public in the State of Illinois and, as such, is a public utility within the meaning of the Public Utilities Act;
- (2) the Commission has jurisdiction over The Peoples Gas Light and Coke Company and of the subject matter of this proceeding;
- (3) the recitals of fact and the conclusions reached in the prefatory portion of this Order are supported by the record and are hereby adopted as findings of fact;
- (4) The Peoples Gas Light and Coke Company has filed a reconciliation of revenue collected under its purchased gas adjustment clause (Rider 2, Gas Charge, of Respondent's Schedule of Rates) with the actual costs prudently incurred and recoverable under Rider 2, for the twelve months ended September 30, 2006, and for the three months ended December 31, 2006;
- (5) The Peoples Gas Light and Coke Company should implement Factor O refunds of \$571,933.44 through its Commodity Gas Charge in its first monthly Gas Charge filing after the date of this Order;
- (6) the Commission finds that Peoples Gas' use of Manlove Field, including the provision of interstate hub services during the Reconciliation Period, was prudent;
- (7) in its direct testimony in its 2008 Gas Charge reconciliation proceeding, The Peoples Gas Light and Coke Company shall explain its Manlove Field capacity allocations among Peoples Gas' customers, North Shore Gas Company's customers, and Peoples Gas' interstate hub services and explain how the allocation decision fits into its entire asset portfolio;

- (8) the Commission approves The Peoples Gas Light and Coke Company's reconciliation statement as reflected in Appendix A and Appendix B to this Order; and
- (9) all motions, petitions, objections or other matters in this proceeding which remain undisposed of should be disposed of consistent with the conclusions herein.

IT IS THEREFORE ORDERED that The Peoples Gas Light and Coke Company's purchased gas reconciliation of costs actually incurred for the purchase of natural gas with revenues received for such costs, for the fifteen month Reconciliation Period ended December 31, 2006, as set forth in Appendix A and Appendix B to this Order, be, and is hereby, approved.

IT IS THEREFORE ORDERED that, in its direct testimony in its 2008 Gas Charge reconciliation proceeding, The Peoples Gas Light and Coke Company shall explain its Manlove Field capacity allocations among Peoples Gas' customers, North Shore Gas Company's customers, and Peoples Gas' interstate hub services and explain how the allocation decision fits into its entire asset portfolio

IT IS FURTHER ORDERED that The Peoples Gas Light and Coke Company should refund the Commodity Gas Charge Factor O of \$571,933.44 beginning with the first monthly filing following the issuance of this Order.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

DATED:
BRIEFS ON EXCEPTIONS DUE:
REPLY BRIEFS ON EXCEPTIONS DUE:

May 19, 2010
May 25, 2010
May 30, 2010

Katina Haloulos Baker
Administrative Law Judge